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IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

OFFICIAL COMMITTEE OF CUSTOMERS OF COLUMBIA GAS TRANSMISSION CORPORATION, PENNSYLVANIA PUBLIC UTILITY COMMISSION, *et al.*, CITIES OF CHARLOTTESVILLE AND RICHMOND, VIRGINIA,
Cross-Petitioners,

v.

OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF COLUMBIA GAS TRANSMISSION CORPORATION,
Cross-Respondent.

On Cross-Petitions for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF IN OPPOSITION OF CROSS-RESPONDENTS OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF COLUMBIA GAS TRANSMISSION CORPORATION

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QUESTION PRESENTED

Whether the Third Circuit properly required trust claimants to trace the alleged trust funds to property held by the alleged trustee, a debtor in bankruptcy.

LIST OF PARTIES AND RULE 29.1 LIST

The caption of the decision below (Pet. App. 1a-37a) contains the names of the parties.

The Creditors Committee is the exclusive, official body appointed by the United States Trustee pursuant to Section 1102 of the Bankruptcy Code, 11 U.S.C. § 1102, to represent the interests of all of the unsecured creditors of Columbia Gas Transmission Corporation.*

A substantial number of these unsecured creditors are publicly-owned corporations or affiliates or subsidiaries of publicly-owned corporations. According to the Creditors Committee's records, the following are twenty of the largest publicly-owned creditors:

Ashland Exploration, Inc.
(subsidiary of Ashland Oil, Inc.)

Atlas Resources Inc.

Columbia Gas of Ohio Inc.
(subsidiary of The Columbia Gas System, Inc.)

The Columbia Gas System, Inc.

Columbia Natural Resources Inc.
(subsidiary of The Columbia Gas System, Inc.)

Consolidation Coal Co.
(division of E.I. DuPont de Nemours & Co.)

Energy Development Corporation
(subsidiary of Enterprise Diversified Holdings Incorporated, subsidiary of Public Service Enterprise Group Inc.)

Equitable Resources Energy Company
(subsidiary of Equitable Resources, Inc.)

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* The bankruptcy proceedings are currently pending in the United States Bankruptcy Court for the District of Delaware. *See In re Columbia Gas System Inc. and Columbia Gas Transmission Corporation*, Case Nos. 91-803 *et al.* (Bankr. D. Del.).

Exxon Company, U.S.A.
(division of Exxon Corp.)

Kentucky West Virginia Gas Co.
(subsidiary of Equitable Resources, Inc.)

Meridian Oil Production, Inc.
(subsidiary of Burlington Resources, Inc.)

Mountaineer Gas Company
(subsidiary of Allegheny & Western Energy Corp.)

Phillips Petroleum Co.

Phillips Production Co.

Samedan Oil Corporation
(subsidiary of Noble Affiliates, Inc.)

Southeastern Gas Co.
(subsidiary of Northern Engineering Corp., subsidiary of DWG Corp.)

Texas Eastern Transmission Co.
(subsidiary of Texas Eastern, subsidiary of Panhandle Eastern Corp.)

Union Pacific Resources Corporation
(subsidiary of Union Pacific Corp.)

Unocal Exploration Corporation
(subsidiary of Unocal Corp.)

Xplor Corporation

According to the Creditors Committee's records, more than 750 unsecured creditors assert claims of $1 million or more, and more than 2,000 assert claims of $100,000 or more.

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IN THE

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OCTOBER TERM, 1993

No. 93-876

OFFICIAL COMMITTEE OF CUSTOMERS OF COLUMBIA GAS TRANSMISSION CORPORATION,
Cross-Petitioner,

v.

OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF COLUMBIA GAS TRANSMISSION CORPORATION,
Cross-Respondent.

No. 93-879

PENNSYLVANIA PUBLIC UTILITY COMMISSION, *et al.*,
Cross-Petitioners,

v.

OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF COLUMBIA GAS TRANSMISSION CORPORATION,
Cross-Respondent.

No. 93-904

CITIES OF CHARLOTTESVILLE AND RICHMOND, VIRGINIA,
Cross-Petitioners,

v.

OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF COLUMBIA GAS TRANSMISSION CORPORATION,
Cross-Respondent.

On Cross-Petitions for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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BRIEF IN OPPOSITION OF CROSS-RESPONDENT OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF COLUMBIA GAS TRANSMISSION CORPORATION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-47a) is reported at 997 F.2d 1039. The opinion of the district court (Pet. App. 75a-122a) is not reported. The opinion of the bankruptcy court (Pet. App. 123a-144a) is reported at 136 B.R. 930.

JURISDICTION

The judgment of the court of appeals was entered on July 6, 1993. The order of the court of appeals denying the Creditors Committee's petition for rehearing was entered on August 6, 1993. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

Section 541 of the Bankruptcy Code, 11 U.S.C. § 541, provides in pertinent part:

> (a) The commencement of a [bankruptcy] case . . . creates an estate. Such an estate is comprised of . . . all legal or equitable interests of the debtor in property as of the commencement of the case . . . .
>
> (d) Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest . . . becomes property of the estate . . . only to the extent of the debtor's legal

title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

STATEMENT OF THE CASE

A detailed statement of the case is set forth in the petition for a writ of certiorari filed on November 3, 1993, and is hereby incorporated by reference. Accordingly, this statement is directed at the issue raised by the cross-petitions. Shortly after filing with the United States Bankruptcy Court for the District of Delaware a petition for voluntary bankruptcy pursuant to Chapter 11 of the Bankruptcy Code, see 11 U.S.C. § 1101 *et seq.*, Columbia Gas Transmission Corporation ("Debtor") sought permission from that court to make preferential payments to its customers in satisfaction of pre-petition refund claims totalling approximately $160 million. The bankruptcy court created new substantive federal common law divorced from any identifiable common law trust principles and granted the Debtor's request. Because commingling of funds by the Debtor precluded specific tracing of the trust funds, however, the bankruptcy court limited the customers' recovery on refunds received prior to bankruptcy to $3.3 million—the amount in the Debtor's general accounts on the petition date.

The United States District Court for the District of Delaware never reached the tracing issue because it reversed the bankruptcy court's decision, properly concluding that no trust existed under applicable state law principles. Pet. App. at 100a-101a. The Third Circuit reversed the district court, holding that newly-created federal common law should govern resolution of the trust issues. *Id.* at 47a. The Third Circuit also agreed with the bankruptcy court, however, that the customers must trace the trust funds to property held by the Debtor and limited recovery on refunds received prior to bankruptcy to $3.3 million. *Id.* at 67a.

REASONS FOR DENYING THE CROSS-PETITIONS

The issue raised by the cross-petitioners—the application of established trust fund tracing principles—does not warrant review by this Court. In urging the Court to consider this issue, cross-petitioners have failed to demonstrate that any of the traditional reasons for granting certiorari exist. The ruling below applying the trust fund tracing requirement does not conflict with any decision of this Court or any other court of appeals. To the contrary, both this Court and the courts of appeals have consistently and uniformly required tracing. Nor does the Third Circuit's straightforward application of the tracing requirement present any issue of general or continuing importance that needs to be decided by this Court.

Indeed, by virtue of their repeated criticisms of the Third Circuit's choice of law analysis, the cross-petitions actually underscore the need for this Court to review the central issue raised in the certiorari petition—that is, identification of the proper body of law to be applied to trust determinations in bankruptcy. Accordingly, review of the issue raised by the petition for writ of certiorari should be granted while review of the tangential issues raised in the cross-petitions should be denied.

1. Cross-petitioners fail to identify any conflict in decision or principle posed by the Third Circuit's routine application of tracing principles. This is because a uniform and well-established body of law exists with respect to the trust fund tracing requirement, a body of law "untainted" by any circuit split or controversy.[1] The courts of appeals

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[1] This Court and the circuit courts have uniformly enunciated the general rule that any party attempting to impress a trust upon funds for the purpose of excluding those funds from the bankruptcy estate bears the burden of sufficiently tracing the trust fund property where such property has been commingled with the general property of the debtor. *See United States* v. *Randall*, 401 U.S. 513 (1971); *Cunningham* v. *Brown*, 265 U.S. 1, 11 (1924); *Schuyler* v. *Littlefield*, 232 U.S. 707, 710 (1914); *First Fed.* v.

have uniformly identified the lowest intermediate balance test as the proper mechanism for implementing the tracing requirement and determining beneficiaries' rights in commingled funds.[2] See *First Fed.* v. *Barrow*, 878 F.2d 912, 916 (6th Cir. 1989); *In re R & T Roofing Structures*, 887 F.2d 981, 987 (9th Cir. 1989); *Connecticut Gen. Life Ins. Co.* v. *Universal Ins. Co.*, 838 F.2d 612, 619 (1st Cir. 1988); *Nation-Wide Check Corp.* v. *Forest Hills Distribs., Inc.*, 692 F.2d 214, 216 (1st Cir. 1982); see also *In re Al Copeland Enters., Inc.*, 991 F.2d 233, 235 n.1 (5th Cir. 1993). This uniform acceptance of the lowest intermediate balance test makes further review of the issue by this Court completely unnecessary and unwarranted.

Indeed, cross-petitioners' argument amounts to no more than a general fairness challenge to the well-entrenched tracing requirement. See, *e.g.*, Committee of Customers' Cross-Pet. at 3. However, the tracing requirement's widespread acceptance is rooted in the careful balance it strikes between the rights of bankruptcy creditors and the rights of trust beneficiaries whose funds are held by the debtor. Tracing principles provide a means of distinguishing trust assets, to which the trust beneficiary can lay priority claim, from non-trust assets, which are the property of the estate and against which the trust beneficiary is in no better position than any general unsecured

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Barrow, 878 F.2d 912, 915 (6th Cir. 1989); *In re Bullion Reserve of N. Am.*, 836 F.2d 1214, 1218 (9th Cir.), *cert. denied*, 486 U.S. 1056 (1988); *Connecticut Gen. Life Ins. Co.* v. *Universal Ins. Co.*, 838 F.2d 612, 618 (1st Cir. 1988); *In re Mahan & Rowsey, Inc.*, 817 F.2d 682, 684-85 (10th Cir. 1987); *Sonnenschein* v. *Reliance Ins. Co.*, 353 F.2d 935, 937-38 (2d Cir. 1965); *American Serv. Co.* v. *Henderson*, 120 F.2d 525, 531 (4th Cir. 1941).

[2] Indeed, given the well-settled requirement that trust property must be clearly identified before it can be distributed, the judicially constructed lowest intermediate balance test challenged by the cross-petitioners actually helps beneficiaries by deeming funds adequately traced that were in fact held in commingled accounts.

creditor.[3] In exchange for this priority of payment accorded to beneficiaries, which represents a departure from the bankruptcy norm of equality of distribution, the law imposes the burden of tracing such trust funds on the party seeking the preferential exception.[4] In this manner, the tracing requirement effectuates the Bankruptcy Code's mandate that trust beneficiaries receive priority distribution only as to *trust* property.[5]

Ultimately the cross-petitioners are simply challenging the application of well-settled law to the facts of this case. The Committee of Customers contends that this Court

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[3] *See, e.g., Gulf Petroleum, S.A.* v. *Collazo*, 316 F.2d 257, 261-62 (1st Cir. 1963) ("with respect to any portion of the fund which cannot be identified or traced into other property [the claimant] must perforce be relegated to proving its claim as a general creditor against the bankrupt estate"); *Haley, Chisholm & Morris, Inc.* v. *Parrish*, 127 B.R. 366, 371 (W.D. Va. 1991) ("[i]f the [trust beneficiary] does not take these steps to facilitate tracing, then he, like his brother the secured creditor who has not recorded his security interest, will be treated, after the initiation of bankruptcy proceedings, no differently than an unsecured creditor").

[4] *See, e.g., In re Bullion Reserve*, 836 F.2d at 1218 (the "tracing requirement is necessary to further the Bankruptcy Code's policy of equal distribution among similarly situated creditors"); *In re Lehigh & N. Eng. Ry.*, 657 F.2d 570, 579 (3d Cir. 1981) (to protect secured and unsecured creditors' interests, beneficiaries of trust funds bear the burden of tracing those funds).

[5] The cross-petitioners' concerns regarding the routine application of trust fund tracing principles are properly addressed to Congress, not the federal courts. Congress has on occasion expressly relaxed the common-law tracing requirement where it has deemed it necessary. *See, e.g., Begier* v. *IRS*, 496 U.S. 53 (1990) (finding clear congressional intent to relax the tracing requirement for tax trusts). Neither the language nor the legislative history of the Natural Gas Act, however, provides any indication that Congress intended to do so with regard to refund claims of gas distribution companies. Moreover, nothing prevents the Federal Energy Regulatory Commission from ordering pipeline companies to segregate trust funds from other funds to facilitate tracing in the event of bankruptcy.

should review the Third Circuit's application of the lowest intermediate balance test to the pre-petition refunds because the Debtor merely acted as a conduit for payment from upstream pipeline companies to downstream customers and because it possessed both the intention and means to replenish the account. Committee of Customers' Cross-Pet. at 3. In essence, cross-petitioners are asking the Court to examine the intricacies of Columbia's role as a conduit as well as its ability and willingness to replenish the funds. The highly factual, case-specific nature of these contentions renders the issue inappropriate for review.

2. The cross-petitions, though failing to merit review in their own right, nonetheless underscore the need to grant certiorari on the real issue in this case—namely, determination of the applicable body of law governing the status and disposition of the disputed funds. Indeed, the Cities' cross-petition formulates the "threshold question" as "whether trust law should be applied at all to determine the extent of Debtor's interest in the refunds . . . ." Cities of Charlottesville and Richmond, Virginia Cross-Pet. at 5. They also apparently agree with petitioners that this Court's review is mandated because the Third Circuit's application of federal common law of trusts undermines the policies underlying the Bankruptcy Code. *Id.* at 13. Similarly, the State Agencies' cross-petition concedes that "[t]he appropriate federal law to be applied is an important question which should be settled by this Court." State Agencies' Joint Cross-Pet. at 9. Although styled as cross-petitions for certiorari on the tracing rule issue, the thrust of the Cities and State Agencies' argument is no different from that urged in the petition. To this extent, petitioners and cross-petitioners are in agreement that the Third Circuit applied the wrong body of law to this case.

The question of what body of law governs trust determinations in bankruptcy clearly is one that needs to be

decided by this Court. The decision below has exacerbated the existing conflict among the circuits with respect to the appropriate scope of federal common law preemption, and thus presents a proper vehicle for resolving that split.

CONCLUSION

The cross-petitions for a writ of certiorari should be denied.

Respectfully submitted,

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